



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Office of General Counsel

CFTC Letter No. 11-07  
No-Action  
October 24, 2011  
Office of General Counsel

Michael S. Sackheim, Esq.  
Sidley Austin LLP  
787 Seventh Avenue  
New York, NY 10019

Re: Taiwan Futures Exchange's Request for No-Action Relief in Connection with the Offer and Sale in the United States of its Futures Contract Based on the GreTai Securities Market Capitalized Weighted Stock Index

Dear Mr. Sackheim:

This is in response to your requesting letter, attachments, and electronic mail dated from September 4, 2008 to March 2, 2010, requesting on behalf of Taiwan Futures Exchange ("TAIFEX") that the Office of General Counsel ("Office") of the Commodity Futures Trading Commission ("Commission" or "CFTC") issue a "no-action" letter in connection with the offer and sale in the United States of TAIFEX's futures contract based on the Gretai Securities Market Capitalized Weighted Stock Index ("GTEX" or "Index").

We understand the facts to be as follows. TAIFEX, originally the Taiwan International Mercantile Exchange,<sup>1</sup> is a futures exchange formed in 1998 pursuant to the joint efforts of the Taiwanese government and the private sector.<sup>2</sup> TAIFEX is subject to regulation under Taiwan's

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<sup>1</sup> Further information on TAIFEX is available on its English language website, [http://www.taifex.com.tw/eng/eng\\_home.htm](http://www.taifex.com.tw/eng/eng_home.htm)

<sup>2</sup> This Office previously has granted no-action relief in connection with TAIFEX's futures contracts based on: (1) the Taiwan Stock Exchange ("TWSE") Non-Finance Non-Electronic Sub-Index, *see* CFTC Staff Letter No. 08-06, [2007-2009 Transfer Binder] Comm. Fut. Rep. L. (CCH) ¶ 30,809 at 61,824 (CFTC April 1, 2008); (2) the TWSE Electronic Sector and Finance Sector Indices, *see* CFTC Staff Letter No. 05-08, [2005-2007 Transfer Binder] Comm. Fut. Rep. L. (CCH) ¶ 30,077 at 57,311 (CFTC May 16, 2005); and (3) the TWSE Index ("TAIEX"); *see* CFTC Staff Letter No 04-16, [2003-2004 Transfer Binder] Comm. Fut. Rep. L. (CCH) ¶ 29,781 at 56,265 (CFTC June 2, 2004). In addition, the CFTC granted Regulation 30.10 relief to certain

Futures Trading Law of 2002, administered by the Financial Supervisory Commission (“FSC”). Created on July 1, 2004, the FSC is an all-inclusive regulatory body that supervises the development, operation, and financial stability of various financial markets, including securities, futures, over-the-counter derivatives, financial holding companies, banking institutions, and other financial services companies.<sup>3</sup>

The GTEX is a non-narrow-based, market-capitalization-weighted index maintained and calculated by the GreTai Securities Market (“GTSM”), an over-the-counter securities market in Taiwan formed in 1994 as a non-profit organization modeled after NASDAQ.<sup>4</sup> Developed with a base value of 100 since November 1, 1995, the GTEX is designed to be the most representative measure of the overall performance of stocks listed and traded for more than one month on the board of the GTSM, excluding supervised stocks and emerging stocks.<sup>5</sup> The Index is calculated in real time and disseminated through electronic media every minute from 9:00 a.m. to 1:35 p.m. Taiwan time.<sup>6</sup> Based on your letter, stocks of newly listed companies are included in the sample from the first trading day of the next month following one full calendar month from listing; provided that stocks of listed companies converted into financial holding companies are included in the sample from the day of listing.<sup>7</sup> Stocks suspended from trading are included in the sample from the first trading day of the next month following one full calendar month from reinstatement of normal trading; provided that stocks suspended from trading because of issuance of replacement shares due to capital reduction resulting from a corporate split are included in the sample from the day of resuming trading of the new shares.<sup>8</sup>

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firms, designated by TAIFEX, with respect to the application of the Commission’s foreign futures and options requirements based upon substituted compliance with comparable Taiwan regulatory and TAIFEX self-regulatory requirements consistent with the Commodity Exchange Act (“CEA”) and CFTC regulations. *See* 72 Federal Register 14413 (March 28, 2007).

<sup>3</sup> *See* letter from Michael S. Sackheim, Esq., Sidley Austin LLP to Terry Arbit, General Counsel, CFTC, dated September 4, 2008 (“Sackheim letter”) at 2.

<sup>4</sup> *See* Sackheim letter at 5. Although still known as the GTSM, the entity was incorporated into the government-owned Securities and Futures Financial Holding Company on July 1, 2006, when it became the Taiwan OTC Exchange (“TWO”), <http://www.chinapost.com.tw/business/detail.asp?GRP=E&id=74669>.

<sup>5</sup> *See* Sackheim letter at 8.

<sup>6</sup> The index value is disseminated to financial news vendors and posted on the GTSM website at <http://www.otc.org.tw/ch> (Chinese homepage) and <http://www.otc.org.tw/en> (English homepage).

<sup>7</sup> *See* Sackheim letter at 8.

<sup>8</sup> *Id.*

Based on Bloomberg data reviewed by CFTC staff, the total market capitalization of the stocks in the Index was approximately US \$52 billion, with 575 stocks in the Index as of September 12, 2011. The stocks comprising the lowest 25 percent of the Index (in terms of weighting) over the six-month period ending on September 12, 2011, had an aggregate value of average daily trading volume of US \$116.25 million. In addition, the largest stock in the Index represented 4.84 percent of the Index, and the five most heavily weighted stocks accounted for 15.59 percent of the Index.

The GTEX futures contract began trading on October 8, 2007. The trading day of the futures contract is the business day of the GTSM. The trading hours are from 8:45 a.m. to 1:30 p.m. Taiwan time. The futures contract provides for cash settlement.<sup>9</sup> Prices are quoted in Index points, with each Index point equal to TWD\$200 per contract (about US \$6.78 per contract).<sup>10</sup> The minimum price fluctuation is 0.05 Index point (about US \$0.34). GTEX lists for trading in the spot month, the next calendar month and the next three quarterly months. The last trading day is the third Wednesday of the delivery month. Final settlement occurs on the last trading day. The final settlement price is the simple average of the underlying index during the last 30 minutes prior to the close.<sup>11</sup>

The Commodity Exchange Act (“CEA” or “Act”)<sup>12</sup> provides that the offer or sale in the U.S. of futures contracts based on a group or index of securities, including those contracts traded on or subject to the rules of a foreign board of trade, is subject to the Commission’s exclusive jurisdiction,<sup>13</sup> with the exception of security futures products,<sup>14</sup> over which the Commission

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<sup>9</sup> See Sackheim letter at 3-4.

<sup>10</sup> See <http://www.bloomberg.com/personal-finance/calculators/currency-converter/>

<sup>11</sup> This calculation method of the final settlement price took effect as of November 21, 2008. See *Q&A on Adjustment of Final Settlement Price of Stock Index Futures and Options Contracts*, [http://www.taifex.com.tw/eng/eng2/dev\\_plans/20081127index%20futures%20and%20opitons,%20DM%20revision.pdf](http://www.taifex.com.tw/eng/eng2/dev_plans/20081127index%20futures%20and%20opitons,%20DM%20revision.pdf)

<sup>12</sup> 7 U.S.C. § 1 *et seq.* Effective July 16, 2011, the CEA was substantially amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010) (“Dodd-Frank Act”). Citations to the CEA herein refer to the CEA as amended by the Dodd-Frank Act, unless otherwise indicated.

<sup>13</sup> See CEA Section 2(a)(1)(C)(ii).

<sup>14</sup> A security futures product is defined as a security future or any put, call, straddle, option, or privilege on any security future. See CEA Section 1a(45). A security future, in turn, is defined as a contract of sale for future delivery of a single security or of a narrow-based security index, including any interest therein or based on the value thereof, with certain exceptions. See CEA Section 1a(44).

shares jurisdiction with the Securities and Exchange Commission (“SEC”).<sup>15</sup> Thus, the Commission’s jurisdiction remains exclusive with regard to a futures contract on a group or index of securities that is broad-based.<sup>16</sup>

CEA Section 2(a)(1)(C)(iv) generally prohibits any person from offering or selling a futures contract based on a security index in the U.S., except as permitted under CEA Section 2(a)(1)(C)(ii) or CEA Section 2(a)(1)(D).<sup>17</sup> By its terms, CEA Section 2(a)(1)(C)(iv) applies to futures contracts on security indices traded on both domestic and foreign boards of trade. CEA Section 2(a)(1)(C)(ii) sets forth three criteria to govern the trading of futures contracts on a group or index of securities on designated contract markets:<sup>18</sup>

- (1) the contract must provide for cash settlement;
- (2) the contract must not be readily susceptible to manipulation nor to being used to manipulate any underlying security; and
- (3) the group or index of securities must not constitute a narrow-based security index as defined in CEA Section 1a(35).<sup>19</sup>

While Section 2(a)(1)(C)(ii) provides that no designated contract market may trade a security index futures contract unless it meets the three criteria noted above, it does not explicitly

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<sup>15</sup> See CEA Section 2(a)(1)(D).

<sup>16</sup> See CEA Section 2(a)(1)(C)(ii).

<sup>17</sup> CEA Section 2(a)(1)(D) governs the offer and sale of security futures products.

<sup>18</sup> CEA Section 2(a)(1)(C)(ii) sets forth the same criteria to govern the trading of futures contracts on a group or index of securities on a registered derivatives transaction execution facility (“DTEF”). However, the DTEF category no longer exists since, effective July 16, 2011, Section 734(a) of the Dodd-Frank Act repealed former CEA Section 5a, which previously had authorized such trading facilities.

<sup>19</sup> An index is a “narrow-based security index” under both the CEA and the Securities Exchange Act of 1934 (“Exchange Act”), 15 U.S.C. § 78a *et seq.*, if it has any one of the following four characteristics: (1) nine or fewer component securities; (2) any one of its component securities comprises more than 30% of its weighting; (3) the five highest weighted component securities in the aggregate comprise more than 60% of the index’s weighting; or (4) the lowest weighted component securities comprising, in the aggregate, 25% of the index’s weighting have an aggregate dollar value of average daily trading volume of less than \$50 million (or in the case of an index with 15 or more component securities, \$30 million). See CEA Section 1a(35)(A)(i)-(iv); Exchange Act Section 3(a)(55)(B)(i)-(iv). Thus, an index that does not have any of these elements is not a narrow-based security index for purposes of CEA Section 2(a)(1)(C)(ii). See also CEA Section 1a(35)(B); Exchange Act Section 3(a)(55)(C).

address the standards to be applied to a foreign security index futures contract traded on a foreign board of trade. This Office has applied those same three criteria in evaluating requests by foreign boards of trade to allow the offer and sale within the U.S. of their foreign security index futures contracts when those foreign boards of trade do not seek designation as a contract market to trade those products.<sup>20</sup>

Accordingly, Commission staff has examined the GTEX and TAIFEX's futures contract based thereon, to determine whether the Index and the futures contract meet the requirements enumerated in CEA Section 2(a)(1)(C)(ii). Based on the information noted herein and as set forth in the letter, attachments, facsimiles and electronic mail cited above, we have determined that the GTEX, and TAIFEX's futures contract based thereon, conform to these requirements.<sup>21</sup>

In determining whether a foreign futures contract based on a foreign security index is not readily susceptible to manipulation or being used to manipulate any underlying security, one preliminary consideration is the requesting exchange's ability to access information regarding the securities underlying the index. As noted above, all of the component securities in the GTEX are listed and traded on the GTSM. The requesting letter indicates that TAIFEX has an existing joint surveillance and information sharing agreement with the GTSM, the TWSE, and the Taiwan Securities Central Depository Co., Ltd.<sup>22</sup> Accordingly, TAIFEX should have access to information necessary to

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<sup>20</sup> With regard to the third criterion, the CFTC and SEC jointly promulgated Rule 41.13 under the CEA and Rule 3a55-3 under the Exchange Act, governing security index futures contracts traded on foreign boards of trade. These rules provide that "[w]hen a contract of sale for future delivery on a security index is traded on or subject to the rules of a foreign board of trade, such index shall not be a narrow-based security index if a futures contract on such index were traded on a designated contract market or registered derivatives transaction execution facility." CFTC Rule 41.13, 17 C.F.R. § 41.13; Exchange Act Rule 3a55-3, 17 C.F.R. § 240.3a55-3.

<sup>21</sup> In making this determination, Commission staff has concluded that the GTEX does not have any of the elements of a narrow-based security index as enumerated in CEA Section 1a(35)(A). Accordingly, the Index would not be a narrow-based security index if traded on a designated contract market.

<sup>22</sup> Dated June 30, 2000, the joint surveillance and information sharing agreement requires all parties to the agreement to share information regarding any: (1) domestic and foreign material political and economic extraordinary events; (2) material contract default; and (3) breakdown or interruption of trading systems. In addition, GTSM is required to share with the other contracting parties information regarding: (1) financial crisis or material fraud of securities firms; (2) material delay in settlement by securities firms; (3) material illegal trading by securities firms or investors or the initiation of material litigation concerning the securities firms; and (4) financial crisis or material fraud of the listed company. TAIFEX is required to share with the other contracting parties information regarding (1) financial crisis; (2) material fraud by FCMs, introducing brokers or clearing members; (3) open position reaching a certain amount; and (4) material illegal trading by the FCMs, introducing brokers, clearing members or the investors, or the initiation of material litigation concerning the FCMs, introducing brokers and clearing members. *See* Sackheim letter at 12-13.

detect and deter manipulation. In the event that TAIFEX is unable to obtain access to adequate surveillance information in this regard, or is unable, either directly or through its regulator, the FSC, to share such information with the Commission, this Office reserves the right to reconsider the position taken herein.<sup>23</sup>

In light of the foregoing, this Office will not recommend any enforcement action to the Commission based on Sections 2(a)(1)(C)(iv), 4(a), or 12(e) of the CEA, as amended, if TAIFEX's futures contract based on the GTEX is offered or sold in the U.S. Because this position is based upon facts and representations contained in the requesting letter, attachments, facsimiles and electronic mail cited above, it should be noted that any different, omitted or changed facts or conditions might require a different conclusion. This position also is contingent on the continued compliance by TAIFEX with all regulatory requirements imposed by the FSC, and the applicable laws and regulations of Taiwan. In addition, this position may be affected by any rules that the Commission may adopt regarding futures contracts based on non-narrow-based security indices.

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<sup>23</sup> TAIFEX has agreed to cooperate with the Commission's requests for information regarding the trading of its futures contract based on the GTEX. *See* Sackheim letter at 12. TAIFEX also is a signatory to the International Information Sharing Memorandum of Understanding and Agreement signed on March 15, 1996, at Boca Raton, Florida. In addition, as noted above, TAIFEX has been issued exemptive relief by the Commission pursuant to Commission Regulation 30.10, 17 C.F.R. 30.10, under which TAIFEX has represented that it will cooperate with the Commission with regard to any inquiries concerning foreign futures and options transactions. TAIFEX has signed a number of information-sharing memoranda of understanding ("MOU") with various foreign exchanges, *e.g.*, the Korea Futures Exchange ("KOFEX") in November 2002; the Tokyo International Financial Futures Exchange ("TIFFE") in June 2003; the Tokyo Commodity Exchange ("TOCOM") in February 2004; the New York Mercantile Exchange ("NYMEX") in October 2004; the Osaka Securities Exchange ("OSE") in May 2006; the Chicago Mercantile Exchange ("CME") in October 2006; and the Thailand Futures Exchange ("TFEX") in April 2007. TAIFEX's regulator, the FSC, entered into a MOU with the United States in January 1993, creating arrangements to exchange supervisory, surveillance, and investigatory information in order to assist the regulatory authorities in Taiwan and the United States in securing compliance with their laws, rules and regulations regarding futures matters. The FSC also is a signatory to the IOSCO Multilateral MOU and the Declaration on Cooperation and Supervision of International Futures Markets and Clearing Organizations, as amended, signed on March 15, 1996, at Boca Raton, Florida. *See* [http://www.iosco.org/library/index.cfm?section=mou\\_siglist](http://www.iosco.org/library/index.cfm?section=mou_siglist) and [http://www.iosco.org/library/declarations/pdf/boca\\_declaration.pdf](http://www.iosco.org/library/declarations/pdf/boca_declaration.pdf), respectively.

The offer and sale in the U.S. of TAIFEX's futures contract based on the GTEX is, of course, subject to Part 30 of the Commission's regulations, which governs the offer and sale of foreign futures and foreign option contracts in the U.S.<sup>24</sup>

Sincerely,

Dan M. Berkovitz  
General Counsel

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<sup>24</sup> See 17 C.F.R. Part 30.